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No. 90-1382

In the Supreme Court of the United States

OCTOBER TERM, 1990

ROBERT L. MCCULLOUGH AND
MARY NAN MCCULLOUGH, PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION,
AS RECEIVER OF TWIN CITY SAVINGS, FSA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly applied the rule of *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), by allowing the Federal Savings and Loan Insurance Corporation to enforce a note and a mortgage it acquired as receiver of a failed savings institution, despite petitioners' defenses based upon the institution's alleged breach of an oral side agreement.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A24) is reported at 911 F.2d 593. The opinion of the district court (Pet. App. B1-B8) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on September 10, 1990. A petition for rehearing was denied on November 9, 1990. Pet. App. C1-C2. The petition for a writ of certiorari was filed on February 7, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Twin City Savings Bank, FSB ("Old Twin City") was a federally insured thrift. In August 1985, petitioners orally agreed to purchase several pieces of Alabama property mortgaged to Old Twin City, including 486 acres in Covington County and certain oil leases. Pet. App. A3. The property was owned by Charles Little, an Old Twin City customer who had been experiencing serious financial difficulty. *Id.* at A3-A4. As part of the transaction, petitioners agreed to assume Little's $1,030,000 debt to Old Twin City. *Ibid.*

Old Twin City was anxious to consummate the transaction in order to bolster its own financial picture before the anticipated arrival of federal examiners, who were expected to view Old Twin City's loans to Little as an unacceptable credit risk. Petitioners were aware of the thrift's concern. Pet. App. A4. In October 1985, as an accommodation to the president of Old Twin City, petitioners executed a promissory note, a mortgage covering certain property transferred by Little, and an assignment of the rents derived from the mortgaged property in favor of Old Twin City. *Id.* at A4-A5, B3. The loan documents that petitioners signed did not reflect all of the terms to which the parties previously had agreed orally. Specifically, they did not include the Covington County acreage or the oil leases among the property conveyed to petitioners. *Ibid.*

Despite assurances from Old Twin City officials that the transaction would be closed properly once the federal examiners had left the thrift, and despite petitioners' repeated requests for proper documentation of the transfer of Little's properties to them, by May 1986 petitioners still had not received completed closing papers. Pet. App. A5. Petitioners then met with Little and with Old Twin City officials to demand formal documentation of the transfer of title to Little's property and to insist on certain modifications of

the terms of the promissory note. *Ibid.* Little's attorney subsequently provided petitioners with documents purporting to transfer title to them. After Little filed for bankruptcy in October 1986, petitioners discovered that title to the Covington County property and to the oil leases had never, in fact, been conveyed. *Id.* at A6. In January 1987, petitioners informed Old Twin City that they would make no further payments on the note until they received title to the Covington County property and the oil leases. *Ibid.*

2. In August 1987, the Federal Home Loan Bank Board (FHLBB) declared Old Twin City insolvent and appointed the Federal Savings and Loan Insurance Corporation (FSLIC) as receiver. Pet. App. A6. The FHLBB simultaneously directed the FSLIC to organize Twin City Savings, FSA ("New Twin City"). *Ibid.* The FHLBB then authorized a purchase and assumption transaction under which New Twin City purchased from the receiver substantially all of the assets and assumed substantially all of the liabilities of Old Twin City. Among the assets purchased by Old Twin City were the note, mortgage, and assignment of rents executed by petitioners. *Id.* at A6-A7.

3. In April 1988, New Twin City sued petitioners in the United States District Court for the Middle District of Alabama, seeking to collect the outstanding borrowed amount. Pet. App. B4. Petitioners, who did not dispute their failure to repay the outstanding balance, asserted the affirmative defenses of fraudulent inducement and failure of consideration, each based on the failure of Old Twin City to convey the Covington County property and the oil leases under the terms of the parties' oral agreement. *Id.* at A7. Petitioners also sought to have the mortgage declared void because it had not been notarized in accordance with Alabama law. *Ibid.* On November 9, 1988, the district court entered summary judgment in favor of New Twin City, applying the federal common law estoppel rule established in

D'Oench, Duhme & Co. v. *FDIC*, 315 U.S. 447 (1942). The district court also held that when New Twin City acquired petitioners' note from the FSLIC it acquired the FSLIC's status under federal common law as a holder in due course. Pet. App. B5-B8.

On the same day that the district court entered summary judgment in favor of New Twin City, the FHLBB declared New Twin City insolvent and appointed the FSLIC as receiver. Pet. App. A9-A10. While petitioner's motion for reconsideration of the entry of summary judgment was pending, the FSLIC as receiver for New Twin City was substituted as party plaintiff in the action.[1] *Id.* at A10. The district court subsequently denied petitioners' motion for reconsideration. *Id.* at A9.

4. The court of appeals affirmed. Pet. App. A1-A24. The court relied on its holding in *FSLIC* v. *Two Rivers Associates*, 880 F.2d 1267 (11th Cir. 1989), a case decided after the district court's entry of summary judgment, to find that the FSLIC was entitled to the protections afforded by the rule of *D'Oench* when acting as a receiver as well as when acting in its corporate capacity.[2] The court found it unnecessary to decide whether the protections of *D'Oench* and the holder in due course rule extended to New Twin City as the acquirer of the note and mortgage from the FSLIC because, with its appointment as the receiver for New Twin

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[1] The Federal Deposit Insurance Corporation (FDIC) later assumed the FSLIC's role as receiver for New Twin City pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, § 401(a), (f), and (h), 103 Stat. 354, 356, 357. Accordingly, the FDIC is the respondent in this action.

[2] "When the FSLIC decides to liquidate the institution's assets and sues on a note, it is suing in its capacity as receiver. The FSLIC sues in its corporate capacity when it sues on a note that it assumed during a purchase and assumption transaction to save the failed institution." *Two Rivers Associates*, 880 F.2d at 1276.

City, the FSLIC had become the real party in interest. Pet. App. A10-A11.

After examining the scope of *D'Oench* and the important public policy it serves—the protection of the FSLIC from unrecorded arrangements that misrepresent the true financial condition of an insured institution—the court of appeals concluded that petitioners were estopped from asserting the breach of their oral agreement with Old Twin City. Pet. App. A17. The court also held that the rule of *D'Oench* barred petitioners' claim that the improperly notarized mortgage, although valid on its face, was void under Alabama law. The court found that the petitioners had lent themselves to an arrangement likely to mislead banking examiners when they voluntarily signed the mortgage without the presence of a notary. *Id.* at A19-A20.

The court of appeals also rejected petitioners' contention that application of the common law rule of *D'Oench* to the FSLIC as receiver would upset settled commercial expectations under state law. Citing its previous decisions in *FDIC* v. *Gulf Life Ins. Co.*, 737 F.2d 1513 (11th Cir. 1984), and *Gunter* v. *Hutcheson*, 674 F.2d 862 (11th Cir.), cert. denied, 459 U.S. 826 (1982), as well as decisions of other courts of appeals that have have applied *D'Oench* both to the FDIC and to the FSLIC, the court analogized the rule of *D'Oench* to the protections available to a holder in due course under state law. The court found that under state law petitioners' claim concerning the irregularity in the mortgage could not be asserted against a holder in due course. Observing that transfers of obligations to holders in due course occur commonly, the court of appeals concluded that "application of the FSLIC's common law defenses cannot be said to be so disruptive of settled expectations of how Alabama law would effect the commercial transaction at issue that reliance upon federal common law should be questioned." Pet. App. A23.

ARGUMENT

The court of appeals' holding that petitioners' affirmative defenses are barred by the rule of *D'Oench* applies settled principles of law and is not in conflict with any decision of this Court or any other court of appeals. Accordingly, further review is not warranted.

1. Petitioners first argue (Pet. 8-9) that they have been subjected to *ex post facto* liability. In support of that contention, they argue that the court of appeals should not have relied on its holding in *FSLIC* v. *Two Rivers Associates*, *supra*, applying *D'Oench* to the FSLIC in its receivership capacity, because that case was decided after all of the appellate briefs had been filed in this case. Petitioners cite no case in support of their assertion. In fact, it is well established that the constitutional protection against *ex post facto* laws applies only to criminal or penal statutes. *Galvan* v. *Press*, 347 U.S. 522, 531 & n.4 (1954).

To the extent that petitioners may have meant to assert that the application of the *Two Rivers* holding is inconsistent with the nonretroactivity doctrine applied by this Court in civil cases, their argument is equally groundless. None of the factors that led the Court in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), and subsequent cases to give only prospective application to a judicial decision—including (1) whether the decision created new law either by overruling past precedent or by deciding an issue of first impression whose resolution was not clearly foreshadowed; (2) whether retrospective application serves the purposes of the rule; and (3) whether a holding of nonretroactivity is necessary to avoid injustice (404 U.S. at 106-107)—is present here.

First, contrary to petitioners' assertions (Pet. 9 n.8), the holding in *Two Rivers* did not announce a new principle of law. It neither overruled clear past precedent upon which

the litigants relied, nor decided an issue whose resolution was not foreshadowed. To the contrary, the court of appeals in *Two Rivers* expressly found that none of its prior decisions required holding the rule of *D'Oench* inapplicable to the FSLIC in its receivership capacity. Moreover, the court added that this Court's reasoning in *Langley* v. *FDIC*, 484 U.S. 86 (1987), and in *D'Oench* itself compelled it to accord the protections of *D'Oench* to the FSLIC in both its corporate and receivership capacities. *Two Rivers*, 880 F.2d at 1277.[3]

The other factors considered in *Chevron Oil* also support the court of appeals' reliance on the holding in *Two Rivers* to decide this case. As the court of appeals concluded, application of the *D'Oench* protections to the FSLIC in both its corporate and receivership capacities furthers the important purposes underlying the rule of *D'Oench*. This Court has recognized that the FDIC's need to rely on the records of a failed bank is the same regardless of whether it is acting in its corporate or receivership capacity. *Langley*, 484 U.S. at 94-95.

In addition, application of the *Two Rivers* holding does not result in any injustice or hardship to petitioners. While petitioners may not have been aware that *D'Oench* applied to the FSLIC in its receivership capacity when they signed the loan documents (Pet. 11), they should have recognized the possibility that, as negotiable instruments, the note and mortgage might subsequently be acquired by a holder in due course or, in the event of the thrift's insolvency, by the FSLIC in its corporate capacity. Either transfer would have resulted in the loss of the defenses to the enforcement of

[3] Furthermore, as the court of appeals noted (Pet. App. A12-A13 n.4), Congress recently amended 12 U.S.C. 1823(e), a statute providing certain specific protections to the FDIC against unwritten side agreements, to apply to the FDIC in its receivership as well as corporate capacity. FIRREA, Pub. L. No. 101-73, § 217(4), 103 Stat. 256.

their debt of which they now complain. As the court of appeals noted (Pet. App. A19), petitioners could have avoided injury by waiting to sign the documents until all the terms of their agreement had been recorded properly. Under the circumstances, it is not unjust to apply *D'Oench* to bar their defenses to their facially binding obligations.[4]

2. Petitioners next assert (Pet. 13-15) that the court of appeals' application of *D'Oench* to foreclose their defense to the improperly notarized mortgage constitutes a violation of substantive due process. There is no merit to that claim. Petitioners have not been deprived of any property right, but simply have been estopped from asserting certain defenses to the mortgage they executed. They are in the same position that they would be in if Old Twin City had sold the mortgage to a holder in due course. Pet. App. A23. Thus, contrary to petitioners' contentions (Pet. 16-17 n.13), there is no government conduct here that "offends canons of decency and fairness" and no violation of petitioners' due process rights. *Chatham Ventures, Inc.* v. *FDIC*, 651 F.2d 355, 363 (5th Cir. 1981) (finding that 12 U.S.C. 1823(e), the statute shielding the FDIC from defenses based on unrecorded agreements, does not violate due process), cert. denied, 456 U.S. 972 (1982); see also *Campbell Leasing, Inc.* v. *FDIC*, 901 F.2d 1244, 1250 (5th Cir. 1990).

[4] Petitioners suggest (Pet. 11) that their loss of state law defenses results in a denial of equal protection, arguing that there is no rational basis for treating bank customers who owe debts to insolvent banks differently from those with obligations to other institutions. This argument is frivolous. The result in *D'Oench* by itself makes clear that important interests are served by allowing federal agencies liquidating the assets of a failed institution to avoid defenses to facially valid notes based on unrecorded side agreements. Congress recognized the rational bases for the rule of *D'Oench* when it passed 12 U.S.C. 1823(e) and when it recently amended Section 1823(e) to apply to the FDIC in its receivership capacity. See note 3, *supra*.

3. Finally, petitioners argue (Pet. 15-19) that the application of *D'Oench* to bar their defenses upsets settled commercial expectations in contravention of this Court's decision in *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979). Again, petitioners' argument has no merit. In addressing this argument, the court of appeals correctly applied the reasoning of its previous decisions in *FDIC* v. *Gulf Life Ins. Co.*, 737 F.2d at 1517-1518, and *Gunter* v. *Hutcheson*, 674 F.2d at 872.[5] The court of appeals correctly observed that shielding the FDIC from state law defenses such as those asserted by petitioners would grant the FDIC no greater protection from the defenses than are accorded a holder in due course. Because transfers of mortgages and notes to such holders are, in fact, more common than their acquisition by the FDIC, the court correctly concluded, citing *Gulf Life*, 737 F.2d at 1518, that "little dashing of commercial expectations would result from a uniform federal rule protecting the FDIC from such defenses." Pet. App. A21.

[5] The court of appeals' holding is also fully consistent with decisions of other courts of appeals. See, *e.g.*, *FSLIC* v. *Murray*, 853 F.2d 1251, 1256-1257 (5th Cir. 1988); *Firstsouth, F.A.* v. *Aqua Construction, Inc.*, 858 F.2d 441, 443 (8th Cir. 1988); *FDIC* v. *Wood*, 758 F.2d 156, 159 (6th Cir.), cert. denied, 474 U.S. 944 (1985).

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

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